



employer advisor

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Wage Compensation for Corporation Officers

The Internal Revenue Service (IRS) defines when payments to corporate officers constitute wages. The Utah Employment Security Act and associated Administrative Rules defer to the IRS interpretation. In other words, corporate officer wages reportable for IRS purposes are also reportable for state unemployment insurance. Corporate officers are specifically included within the definition of employee for FUTA (Federal Unemployment Tax Act) and the Utah Employment Security Act. When corporate officers perform services for the corporation and receive or are entitled to receive payments, their compensation is considered wages. All corporations should treat payments for services

to officers as wages and not as distributions of cash and property or loans to shareholders.

"S" corporations elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of "S" corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. The Utah Employment Security Act makes no distinction between "S" and "C" corporations. Payments to corporate officers must be reported if services are provided.

The Internal Revenue Code and the Utah Employment Security Act establish that any officer of an "S" or a "C" corporation is an employee of the corporation for employment tax purposes.

Who is an employee of the corporation?

Generally, a corporate officer is a corporate employee. Courts have held that "S" corporation officer/shareholders who provide more than minor services to their corporation and receive or are entitled to receive payment are employees whose compensation is subject to employment taxes.

What is a reasonable salary?

The IRS Form 1120S instructions state that, "Distributions and other payments by an "S" corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation."

No specific guidelines for reasonable compensation exist in the Code or the Regulations, although some factors considered by the courts are listed in the box below. Reference to this subject can be found at: <http://www.irs.gov/newsroom/article/0,,id=200293,00.html> and at www.rules.utah.gov/publicat/code/r994/r994-202.htm#T1.

FACTORS

- Training and experience
- Duties and responsibilities
- Time and effort devoted to the business
- Dividend history
- Payments to non-shareholder employees
- Timing and manner of paying bonuses to key people
- What comparable businesses pay for similar services
- Compensation agreements
- The use of a formula to determine compensation

SUTA Dumping Revisited

What is SUTA dumping? SUTA dumping is the practice of circumventing or manipulating a state's Unemployment Tax Act (SUTA) experience rating system to qualify for a reduced tax rate. This may occur by moving or eliminating ("dumping") Unemployment Insurance (UI) benefit charges from the employer's tax rate calculation. This illegal practice offers an employer a lower tax rate. It also shifts the tax burden to the remaining employers who now must pay higher tax rates. State legislation enacted in 2005 was designed to prevent SUTA dumping in compliance with corresponding federal legislation.

Employers who have higher UI charges for benefits paid to former employees typically have higher UI tax rates than employers who maintain stable workforces. In a typical SUTA dumping scenario, among several that exist, an employer establishes one or more "shell" companies before transferring all or part of its payroll to a shell that has a lower UI rate. The former company's experience is "dumped," the employer's tax liability is reduced, and all employers must offset the lost revenue by paying higher "social costs." The law ensures that employers with higher unemployment experience risks are accountable for them while employers with low unemployment risks are protected.

Section 35A-4-304 (http://le.utah.gov/~code/TITLE35A/htm/35A04_030400.htm) of the Employment Security Act includes specific provisions governing the transfer of unemployment experience and contribution rates.

- The unemployment experience attributable to each employer will be combined when an employer transfers all or part of its trade or business (including its workforce) to another employer and common ownership, management, or control of the employers exists during the transfer.
- Each entity will receive the same UI tax rate for up to four years.
- The law also provides meaningful civil and criminal penalties for individuals, including tax advisors, who knowingly violate or attempt to violate any provision of the legislation.

Utah utilizes an automated system to detect employers who may be involved in UI tax rate manipulation schemes. The state is committed to protecting the UI trust fund and ensuring that all employers pay their rightful amounts.

What is an employer required to do? All parties involved in a transfer must notify the UI Contributions Division within 30 days of the transfer by completing a Form 1 found at our web site <http://jobs.utah.gov/ui/employer/public/forms/form1.pdf> or requested by phone. For questions, contact us at 801-526-9235.

